

CLIENT REPORT:

IRS Tax Tips: Mortgage Debt Forgiveness

Dear Client:

The IRS has posted tax facts for struggling homeowners as part of its Tax Tips series. These tax tips are designed to familiarize taxpayers with special relief that is available if their mortgage debt is partially or entirely forgiven.

Background. When a lender forgives any portion of a mortgage loan, cancellation of debt (COD) income generally results. The amount that is included for COD purposes is equal to the difference between the amount of the debt being cancelled and the amount used to satisfy the debt. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, may qualify for this relief.

Exclusion for Discharge of Qualified Principal Residence Indebtedness. Cancellation of debt income is excludable from income if it is incurred with respect to the taxpayer's principal residence for debts forgiven after January 1, 2007 and before January 1, 2013. This exclusion of discharged qualified residence indebtedness is limited to \$2 million (\$1 million for married taxpayers filing separately).

Principal Residence. Your home must be owned and used by you as a principal residence for 2 years or more during a 5-year period to qualify as a principal residence. In addition, pertinent facts such as your place of employment and mailing address serve to support or refute whether a home is your principal residence.

Acquisition Indebtedness. Acquisition indebtedness must be secured by the principal residence, and incurred in the acquisition, construction, or substantial improvement of the residence. Debt used to refinance qualifying debt is also eligible for the exclusion, but only to the extent that the amount of refinancing does not exceed the debt being paid off.

Non-Qualifying Events. Debt forgiven on second homes, rental property, business property, credit cards or car loans does not qualify for the tax-relief provision. In addition, the exclusion is not available if the discharge of indebtedness is on account of services performed for the lender, or if the discharge is not directly related to a decline in the value of the residence or to the financial condition of the taxpayer.

Reporting Guidelines. If your mortgage debt is forgiven, you must apply the excluded amount to reduce the basis of your principal residence, but not below zero. Your lender should report the amount of debt forgiven and the fair market value of any property given up through foreclosure on Form 1099-C, Cancellation of Debt. The exclusion of part or all of your COD income should be reported on Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment) and attached to your Form 1040.

Exclusion for Home Affordable Modification Program (HAMP) Payments. HAMP is a key component of the U.S. Government's Homeowner Affordability and Stability Plan, which helps at-risk homeowners modify their mortgages to avoid foreclosure. "Pay-for-Performance-Success-Payments" under HAMP reduce the principal balance on your mortgage, and are excludable from income if you make timely payments on your modified loan.

We would be happy to discuss your principal residence debt in order to maximize your tax relief. Please call our office at your earliest convenience to arrange an appointment.

Sincerely yours,

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